

April 24, 1997



David S. Guzy, Chief, Rules and Procedures Staff
Minerals Management Service, Royalty Management Program
P.O. Box 25165, MS 3101
Denver, CO 80225-0165

Re: Proposed Rules
Department of the Interior, Minerals Management Service
30 CFR, Parts 206 and 208 / 62 FR 3742
Establishing Oil Value for Royalty Due on Federal Leases and Sale of Federal Royalty Oil
January 24, 1997

Dear Mr. Guzy:

These comments are submitted on behalf of a coalition of small refiners who currently purchase crude oil through the Royalty In Kind program. The companies submitting these comments are Gary-Williams Energy Corporation in Denver, Colorado, Placid Refining Company in Baton Rouge, Louisiana, Giant Industries Arizona, Inc. in Scottsdale, Arizona, Age Refining, Inc., in San Antonio, Texas, Calcasieu Refining Company in Houston, Texas and Goldline Refining Ltd. in Houston, Texas. All of these companies are small refiners who participate in the RIK program.

The RIK program has proved to be extremely valuable to small refiners. The RIK program allows small refiners to gain access to crude oil at the same price and location that other, much larger, integrated oil purchasers can. The RIK program is ever-more valuable in today's environment as the industry goes through a major consolidation phase, in which very large oil companies control the production, transportation, and refining phases. Such an environment makes it exceedingly difficult for a small and independent refiner to gain access to crude oil at a competitive price, thus putting the small refiner at a large competitive disadvantage. The RIK program, as it is designed today, buffers these concerns.

However, the proposed changes to 30 CFR, Part 206 will, if enacted and applied to the RIK Small Refiners Program (30 CFR, Part 208), destroy the very reason the program is in place, which is to provide access to crude oil to small and independent refiners at a competitive price. Under the proposed pricing formula, there are no assurances whatsoever that the small refiner will be paying market prices for crude oil purchased through the RIK program. Small refiners will be forced to pay on a formulaic basis which bears no relation to actual market prices. As a matter of basic free enterprise theory, the only price that is reasonably fair when valuing crude sold under a contract at the lease is the contract price itself, based ultimately on what a willing buyer will pay and what a willing seller will accept at the point of sale. Any formulaic valuation distorts real market value.

We understand and approve of MMS' desire to provide for certainty in RIK oil valuations in the RIK contracts, but we have numerous problems with the approach MMS has proposed as detailed below.

- * The proposal, using a formula based on NYMEX prices to calculate crude oil prices would have the refiners paying the highest theoretical price, not allowing for any "real" market conditions such as refinery disruptions in the area, pipeline prorations, an influx of competing crudes, etc. Not all crude in a given area is sold at the highest theoretical price. Often a refiner is willing to take only a portion of crude oil from a given area, thus forcing the balance of the crude to be shipped to another area, often at lesser net backs to the producer due to higher transportation costs and different market dynamics. Furthermore, we have serious doubts as to whether any crude oil could ever be sold at the highest theoretical price as outlined in the proposed pricing formula.
- * The proposal will not consider any gross proceeds on a lease-by-lease basis to determine the price charged to the small refiner. This would assure that any "real market conditions" will be ignored, again having the small refiner pay the highest theoretical price, i.e., a formula-derived price, not the market price.
- * The proposal would have the small refineries buying on a spot pricing basis, but on a long-term contractual basis. It is very rare, and often unwise, to purchase all your supply on the spot basis. It is exceedingly rare to do so on a long-term basis.
- * The formula-derived price proposed does not take into account incremental costs that are incurred in getting the crude oil to the NYMEX, such as:
 - a. line loss.
 - b. line transfer fees.
 - c. cost of line fill requirements.
 - d. NYMEX transaction fees.
 - e. over and short covering (to account for discrepancies in delivered volumes vs. volumes sold into the NYMEX).
 - f. cost of margin calls.
 - g. marketing related costs.
 - h. environmental risk costs.
 - i. costs of establishing credit and credit risk.
 - j. costs as a result of price and volume volatility between the time of purchase and the time of sale into the NYMEX.
 - k. various other miscellaneous and administrative costs.
- * There is an inequity in the allowable pipeline cost deduction. The proposal allows for the owners of a given pipeline to only deduct actual transportation costs as approved by the MMS when computing value at the lease, while the small refiner, when

shipping on such a line, will have to pay full FERC tariffs. The FERC tariff will always be more than the approved transportation allowance to equity owners. Thus the small refiner's cost to transport the barrel will be higher than the deduction allowed in the valuation formula.

- * The formula-derived price proposed does not take into account the cost of the RIK program itself. In addition to all the issues stated above, the small refiner would be asked to pay an administrative fee.
- * The proposed form 4415 which attempts to capture location differentials between market centers and aggregations points, updated annually, and if used in the RIK pricing formula, will most certainly further increase the difference between the price the refiner would pay via "formula pricing" and "real market conditions". The requirement to only update such a form annually, and with no assurances of prompt and accurate reporting will keep pricing from approximating actual market costs. We are concerned based on comments made in the public hearings held in Denver and Houston on April 15 and April 17, respectively, about confusion regarding which party is responsible for filing form 4415 and how the information is to be gathered. The accuracy of the information to be contained in form 4415 is critical if the proposed rule is passed in its current form.
- * Utilizing NYMEX pricing in the valuation formula displaces the "point of value" location from the lease to Cushing, Oklahoma. This change of location creates for discrepancy between the actual market value of the crude oil vs. a formula-derived value.
- * The timing for the NYMEX pricing formula is not commensurate with the way pricing is handled in the oil industry. The proposal provides for the prompt month on the NYMEX in effect on the first day of the production month as the only price used when calculating value. This results in creation of additional price risk for the small refiner.
- * Proposed formula pricing does not meet the "fair market value" definition of the Outer Continental Shelf ("OCS") Lands Act. The OCS Lands Act definition provides for computing the price for the crude oil based on unit prices at which minerals were sold from the same lease, and unit prices for minerals sold from other leases in the same region of the OCS. The proposed NYMEX pricing formula for the RIK program is formula-derived only. The proposal does not allow for any pricing from the lease or surrounding area to influence the price billed to small refiners. NYMEX pricing would not provide a "fair market value" for RIK oil; it would establish a formulaic highest theoretical price as the cost charged to small refiners under the RIK program.
- * We believe that the cost of this proposed program to the MMS will increase greatly due to the active role MMS will play in establishing and monitoring prices and allowable deductions in valuing crude oil, as well as additional staff required to handle

the numerous phone calls MMS will receive protesting and questioning the formulaic artificial price established by MMS.

- * The NYMEX is not a true indicator of the value of crude oil in the field due to the high volume of transactions conducted on the NYMEX by non-industry entities. This results in fluctuations in the price shown on the NYMEX, not always reflective of actual market value in the field.

Alternative Proposal

Using a gross proceeds methodology as reported by the interest owners to arrive at a price to charge small and independent refiners is the only way to address the concerns listed above, as well as provide the benefits within and by the program, i.e., providing access to crude oil to small and independent refiners at a fair market price. A gross proceeds methodology also allows the RIK program to fall within the fair market value definition of the OCS Lands Act.

Gross proceeds methodology as reported by the producers assures the small refiner will pay true market price every month, as opposed to a formula-derived price at the lease. Factors such as crude quality, pipeline costs, local supply/demand issues, both positive and negative would be reflected in the price immediately. This in turn will allow the refiner to purchase crude oil at the same price as other crude oil purchasers in the area may, as opposed to the proposed formula methodology which may force a small refiner out of the program simply because the formula-based price does not reflect local market conditions.

The Royalty Policy Committee's recommendation to establish product values in the RIK contract would be an improvement to the RIK program. However, such values cannot be established through a formula-derived price because of the reasons described in detail above. We would recommend setting a lease-by-lease price in the RIK contract based on actual transactions conducted in the field. Even if MMS elects to implement the formula-derived price in 30 CFR, Part 206 despite the problems described above, it is critical that the small refiners continue to purchase crude oil based on actual transactions conducted in the area. It is equally critical that in conjunction with establishing product value in the RIK contract the small refiner not be subject to lengthy audit periods or retroactive pricing liability.

Combined with the gross proceeds methodology should be the suggestions brought forth in the industry "round table" discussions, hosted by the MMS in Denver, Colorado on March 26, 1997 on quality and delivery issues. In that meeting, it was suggested by the small refiners that certain common sense changes or improvements be made to the existing program. Among those changes:

- * The refiner should pay for crude oil based on volume received, not produced.

- * More accountability by the reporters on MMS form 2014, including penalties for failure to turn in data in an accurate and timely fashion.
- * Allowing the refiner to opt back in on purchasing from a lease after the refiner previously elected not to purchase from a lease.
- * Access to the "reporters" information contained in the MMS form 2014, thus allowing the small refiner to validate the pricing information.
- * Retain the option allowing the small refiner to take delivery at an on-shore or off-shore location.
- * Change the program to have accountability on lessees for over/under deliveries. If greater than a 10% volume deficit for the month occurs, the participating refiner should have the option to have the volume made up by the lessee or require the lessee to pay the MMS for the shortage. If greater than a 10% overage occurs, the participating refiner should have the option to buy the volume at the RIK value from the lessee or return the volume to the lessee.

These proposed changes from the round table discussion are brought up in this forum because we believe these changes are necessary to correct ineffectiveness in the program.

Regarding the proposed "pilot" royalty in kind programs, the MMS should not take its royalty in kind to compete in the marketplace. We feel this program would be in direct competition with the spirit and intent of the current small refiner RIK program.

We are confident that the MMS realizes the value of the Royalty In Kind program to the small refiner, especially in the current business climate of consolidations. We are also confident the MMS sees the value of the small independent refiner in the market place. Please strongly consider retaining a gross proceeds methodology for the RIK program. We do not wish for the RIK program to become ineffective simply because a formulaic price is not an accurate gauge of the true market price of a barrel of oil. We simply ask that the program allow us access to crude oil at true market prices.

David S. Guzy
Page 6
April 24, 1997

Thank you for your consideration of our comments.

Very truly yours,

Frank Del Angel
Title: _____
Age Refining, Inc.

Murray Hetherwick
Title: _____
Calcasieu Refining Company

Donald A. Hamilton
Title: _____
Gary-Williams Energy Corporation

Luke Wethers
Title: _____
Giant Industries Arizona, Inc.

Rodney Nelson
Title: _____
Goldline Refining Ltd.

Dennis Cernosek
Title: _____
Placid Refining Company

David S. Guzy
Page 8
April 24, 1997

Thank you for your consideration of our comments.

Very truly yours,



Frank Del Angel

Title: PRESIDENT & C.O.O.

Age Refining, Inc.

Murray Hetherwick

Title:

Calcasieu Refining Company

Donald A. Hamilton

Title:

Gary-Williams Energy Corporation

Luke Wethers

Title:

Giant Industries Arizona, Inc.

Rodney Nelson

Title:

Goldline Refining Ltd.

Dennis Carnosek

Title:

Placid Refining Company

David S. Guzy
Page 6
April 24, 1997

Thank you for your consideration of our comments.

Very truly yours,

Frank Del Angel

Title:

Age Refining, Inc.


Murray Hetherwick

Title:

V-P
Calcasieu Refining Company

Donald A. Hamilton

Title:

Gary-Williams Energy Corporation

Luke Wethers

Title:

Giant Industries Arizona, Inc.

Rodney Nelson

Title:

Goldline Refining Ltd.

Dennis Cernosek

Title:

Placid Refining Company

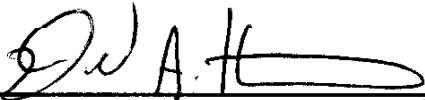
David S. Guzy
Page 6
April 24, 1997

Thank you for your consideration of our comments.

Very truly yours,

Frank Del Angel
Title: _____
Age Refining, Inc.

Murray Hetherwick
Title: _____
Calcasieu Refining Company



Donald A. Hamilton
Title: U.P. Supply
Gary-Williams Energy Corporation

Luke Wethers
Title: _____
Giant Industries Arizona, Inc.

Rodney Nelson
Title: _____
Goldline Refining Ltd.

Dennis Cernosek
Title: _____
Placid Refining Company

David S. Guzy
Page 6
April 24, 1997

Thank you for your consideration of our comments.

Very truly yours,

Frank Del Angel
Title:
Age Refining, Inc.

Murray Hatherwick
Title:
Calcasieu Refining Company

Donald A. Hamilton
Title:
Gary-Williams Energy Corporation

R. L. K. Wethers
Luke Wethers
Title: *Vice President*
Giant Industries Arizona, Inc.

Rodney Nelson
Title:
Goldline Refining Ltd.

Dennis Cernosek
Title:
Placid Refining Company

TEL :

Apr 24 97

23:10 No.011 P.02

From: Don Hamilton To: Rodney Nelson

Date: 4/25/97 Time: 09:00:48

Page 7 of 7

David S. Guzy
Page 7
April 25, 1997

Thank you for your consideration of our comments.

Very truly yours,

Frank Del Angel
Title: _____
Age Refining, Inc.

Murray Hetherwick
Title: _____
Calcasieu Refining Company

Donald A. Hamilton
Title: _____
Gary-Williams Energy Corporation

Luke Wethers
Title: _____
Giant Industries Arizona, Inc.

Rodney Nelson
Rodney Nelson
Title: *Vice President - Marketing*
Gold Line Refining Ltd.

Dennis Cornorek
Title: _____
Placid Refining Company

David S. Guzy
Page 6
April 24, 1997

Thank you for your consideration of our comments.

Very truly yours,

Frank Del Angel
Title:
Age Refining, Inc.

Murray Hetherwick
Title:
Calcasieu Refining Company

Donald A. Hamilton
Title:
Gary-Williams Energy Corporation

Luke Wethers
Title:
Giant Industries Arizona, Inc.

Rodney Nelson
Title:
Goldline Refining Ltd.


Dennis Cernosek
Title: MGR CRUDE OIL SUPPLY
Placid Refining Company